

Message Text

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PAGE 01 LONDON 18000 01 OF 03 011955Z POSS DUPE
ACTION EUR-12

INFO OCT-01 IO-14 ISO-00 AID-05 CEA-01 CIAE-00 COME-00
EB-08 FRB-01 INR-07 NSAE-00 SP-02 STR-05 TRSE-00
LAB-04 SIL-01 OMB-01 USIA-15 NSC-05 SS-15 PA-02
PRS-01 AGRE-00 ITC-01 /101 W
-----057405 012145Z /66

R 011812Z NOV 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 9888
INFO AMEMBASSY BRUSSELS
AMEMBASSY DUBLIN
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UNCLAS SECTION 01 OF 03 LONDON 18000

USEEC ALSO FOR EMBASSY
USOECN ALSO FOR EMBASSY
USMTN

E.O. 11652: N/A
TAGS: EGEN, EEC, UK
SUBJECT: BRITAIN IN THE EUROPEAN COMMUNITY - THE
ECONOMIC IMPACT

1. SUMMARY: THIS, THE FIRST OF A SERIES OF MESSAGES
ON BRITAIN AND THE EUROPEAN COMMUNITY, ASSESSES THE
ECONOMIC IMPACT OF ENTRY INTO THE EC ON THE BRITISH
ECONOMY. NEITHER THE HOPES OF ADVOCATES OF ENTRY, NOR
THE FEARS OF OPPONENTS, HAVE BEEN FULLY REALIZED. INDEED,
THE DIRECT EFFECTS OF EC MEMBERSHIP HAVE IN SEVERAL RE-
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PAGE 02 LONDON 18000 01 OF 03 011955Z POSS DUPE

GARDS BEEN DWARFED BY OTHER EVENTS OR PRESSURES. NEVER-
THELESS, THE COMMUNITY IS IMPORTANT TO BRITAIN'S ECONOMY
AND CONTINUED PARTICIPATION IN THE EC SEEMS THE ONLY
REALISTIC ECONOMIC OPTION. END SUMMARY.

2. IN THE PERIOD OF THE FINAL, SUCCESSFUL NEGOTIATIONS
FOR BRITISH ENTRY INTO THE EC, ANALYSTS, INCLUDING THE

UK GOVERNMENT OFFICIALS WHO WROTE THE WHITE PAPERS OF 1970 AND 1971, FORESAW FOUR PROBABLE EFFECTS OF BRITISH MEMBERSHIP, THREE, IN SOME SENSE, NEGATIVE, ONE POSITIVE:

(A) BRITAIN'S TRADE BALANCE WAS EXPECTED TO WORSEN. THE NET EFFECT OF TARIFF DISMANTLING BETWEEN THE UK AND THE SIX WAS THOUGHT TO BE A MODEST NET INCREASE OF NON-AGRICULTURAL IMPORTS, ON THE ORDER OF ENGLISH POUNDS 125-275 MILLION ANNUALLY. A FURTHER INCREASE IN NET IMPORTS WOULD COME FROM THE HIGHER COST OF FOOD IMPORTS AS A RESULT OF ADOPTION OF THE EC'S COMMON AGRICULTURAL POLICY.

(B) HIGHER FOOD PRICES RESULTING FROM THE CAP WOULD FEED THROUGH TO WAGES AND RENDER BRITISH PRODUCTS SOMEWHAT LESS COMPETITIVE.

(C) BRITAIN WOULD MAKE A LARGISH NET CONTRIBUTION TO THE COMMUNITY BUDGET (A CONTRIBUTION WHICH, AFTER THE TRANSITION PERIOD, WOULD BE LARGE COMPARED TO ITS GDP BECAUSE AS A HEAVY IMPORTER THE CUSTOMS DUTIES AND FOOD IMPORT LEVIES WHICH IT WOULD TURN IN TO BRUSSELS WOULD BE MASSIVE). THIS WOULD FURTHER BURDEN BRITAIN'S PERENNIAL SHAKY BALANCE OF PAYMENTS.

(D) BUT, ON THE OTHER SIDE, IT WAS BELIEVED, OR HOPED, THAT BRITISH ENTRY WOULD HAVE "DYNAMIC" EFFECTS THAT WOULD OFFSET, IN THE LONGER TERM, THE PREDICTABLY NEGATIVE "STATIC" EFFECTS CITED ABOVE. THE HIGHER GROWTH RATE OF THE SIX WAS NOTED, AND IT WAS SUGGESTED THAT UNCLASSIFIED

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PAGE 03 LONDON 18000 01 OF 03 011955Z POSS DUPE

ENTERING THE COMMON MARKET COULD LEAD TO SIMILAR RESULTS FOR THE UK, BY A COMBINATION OF PURELY ECONOMIC EFFECTS (A LARGER MARKET LEADING TO GREATER EFFICIENCY, MORE INVESTMENT, ETC.) AND PSYCHOLOGICAL STIMULUS (THE "COLD SHOWER" THAT WAS SUPPOSED TO AWAKEN BRITISH INDUSTRY FROM ITS SLUMBER).

3. AFTER NEARLY 5 YEARS OF BRITISH MEMBERSHIP THE SITUATION IS QUITE DIFFERENT FROM THE PREDICTIONS.

4. TRADE EFFECTS. BRITAIN'S TRADE DEFICIT WITH THE OTHER EC STATES ROSE RAPIDLY, AND TO MUCH HIGHER LEVELS THAN EXPECTED: FROM 580 MILLION POUNDS IN 1972 TO A PEAK OF 2.4 BILLION POUNDS IN 1975. SINCE THEN IT HAS NARROWED SLIGHTLY, TO 2.2 BILLION POUNDS IN 1976 AND 2.0 BILLION POUNDS IN 1977 (ANNUAL RATE BASED ON FIRST THREE QUARTERS). THE INCREASE IN THE AGRICULTURAL TRADE DEFICIT WITH THE REST OF THE EC WAS ANTICIPATED, BUT THE SWING IN TRADE IN MANUFACTURED GOODS FROM A SURPLUS OF 27 MILLION POUNDS IN 1972 TO A DEFICIT OF 496 MILLION POUNDS IN 1975 AND 370 MILLION POUNDS IN 1977 (BASED ON FIRST TWO QUARTERS) FAR EXCEEDED PREDICTIONS.

5. AGAINST THESE DEVELOPMENTS CAN BE SET:

(A) EXPORTS TO THE EC GREW BY FAR MORE THAN EXPORTS
TO THE REST OF THE WORLD, 306 PERCENT VS. 206 PERCENT

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PAGE 01 LONDON 18000 02 OF 03 011958Z POSS DUPE
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PRS-01 AGRE-00 ITC-01 /101 W
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UNCLAS SECTION 02 OF 03 LONDON 18000

(IN TERMS OF CURRENT VALUES) BETWEEN 1972 AND 1977.

(B) OTHER DEVELOPMENTS, SUCH AS THE PRODUCTION
CRISIS OF 1974 HAVE AFFECTED THE RESULTS, AND EXCHANGE
RATE SHIFTS HAVE PROBABLY SWAMPED THEM.

(C) SOME DEVELOPMENTS OBVIOUSLY HAVE OTHER ROOTS:
THE DEFICIT WITH GERMANY HAS GROWN FROM 252 MILLION
POUNDS IN 1972 TO MORE THAN A BILLION POUNDS IN 1977
(BASED ON FIRST HALF), DESPITE NEARLY 100 PERCENT RE-
VALUATION OF THE DM AGAINST THE POUND. JAPAN, WHICH
CONTINUES TO FACE A TARIFF BARRIER, HAS SINCE 1974 IN-
CREASED ITS SHARE OF THE UK MARKET MORE RAPIDLY THAN THE
EC COUNTRIES.

(D) DESPITE THE OVERALL POOR STATISTICAL OUTTURN,
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PAGE 02 LONDON 18000 02 OF 03 011958Z POSS DUPE

THE LATEST (AUGUST 1977) SURVEY OF LARGE BRITISH MANUFACTURING FIRMS SHOWS THEM TO BE ALMOST UNIVERSALLY PRO-EC, AND FEELING THAT THEY HAVE BECOME MORE COMPETITIVE AS A RESULT OF EC MEMBERSHIP.

6. THE CAP. ON THE OTHER HAND, THE BURDEN OF THE CAP HAS IN SOME WAYS BEEN LESS THAN EXPECTED. INCREASES IN WORLD FOOD PRICES OVER PRE-1973 LEVELS HAVE MEANT THAT BUYING EUROPEAN IS NOT SUCH A SACRIFICE. FURTHERMORE, BRITAIN HAS NOT YET EXPERIENCED THE FULL IMPACT OF CAP PRICE LEVELS BECAUSE OF ITS STUBBORN DEFENSE OF THE GREEN POUND. THE NET ADDITIONAL ANNUAL COST OF FOOD AS A RESULT OF EC MEMBERSHIP HAS BEEN ESTIMATED, BY ENEMIES OF THE EC, AT 400-500 MILLION POUNDS IN 1975-76, WHICH FALLS WITHIN THE VERY BROAD RANGE PREDICTED IN 1971. MORE RECENTLY, PRICES SECRETARY HATTERSLEY ESTIMATED THAT OVER THE PREVIOUS 12 MONTHS THE CAP COULD BE BLAMED FOR ONLY ONE PERCENT OF A 17 PERCENT OVERALL INCREASE IN FOOD PRICES.

7. THE TWO SPECIAL CIRCUMSTANCES COULD BE REVERSED; INDEED WORLD FOOD PRICES ALREADY SEEM ON A DOWNWARD TREND. HOWEVER, IF BRITAIN CAN PRESERVE THE GREEN POUND, OR CAN OBTAIN PRICE DISCIPLINE IN EXCHANGE FOR ABANDONING IT, THE CAP MAY CONTINUE TO BE LESS OF A BURDEN THAN SOME FEARED.

8. BUDGETARY CONTRIBUTIONS. HERE THE EC HAS CLEARLY, UNTIL THIS YEAR, BEEN LESS OF A CHARGE ON THE UK THAN PREDICTED, AS INDICATED BY THE FOLLOWING TABLE:

NET BRITISH CONTRIBUTION TO COMMUNITY BUDGET,
IN MILLION POUNDS

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PAGE 03 LONDON 18000 02 OF 03 011958Z POSS DUPE

1971 FORECAST ACTUAL

1973	100	102
1974	115	31
1975	140	-56
1976	170	170
1977	200	430 (EST)

THE MAJOR FACTOR LIMITING BRITISH CONTRIBUTIONS HAS BEEN THE CONTINUED VALUATION OF THE POUND AS EQUAL TO 2.40 UNITS OF ACCOUNT. A SECOND FACTOR MAY HAVE BEEN SUCCESS IN ATTRACTING A DISPROPORTIONATE SHARE OF EC EXPENDITURE (E.G. OF THE REGIONAL AND SOCIAL FUNDS) TO THE UK.

9. HERE THE SITUATION, AS IN AGRICULTURE, COULD QUICKLY WORSEN. BRITAIN FACES, IN 1978-1980, A STIFF RUNUP IN ITS CONTRIBUTIONS PURSUANT TO ARTICLE 131 OF THE ACCESSION TREATY. THIS INCREASE WOULD BE EVEN GREATER IF THE HIGHER BRITISH SHARE OF THE EC BUDGET IS CALCULATED, AS THE GERMANS INSIST, ON THE BASIS OF THE MARKET VALUE OF THE POUND. BUT, SO FAR, THE BUDGETARY BURDEN HAS BEEN RELATIVELY INSIGNIFICANT.

10. DYNAMIC EFFECTS? BETWEEN 1964 AND 1972 BRITISH GDP GREW AT AN ANNUAL RATE OF 2.4 PERCENT. BETWEEN 1972 AND 1976 THE RATE WAS ABOUT 1-1/2 PERCENT. IT IS ONLY SCANT COMFORT THAT THE EC AS A WHOLE SHOWED A SIMILAR DECLINE (FROM 4.3 PERCENT IN 1964-72 TO 2-1/2 PERCENT IN 1972-76) AS DID GERMANY (FROM 4.4 PERCENT TO 2 PERCENT). THE EVIDENCE OF A PULLING UP OF UK RATES OF GROWTH TO THE EUROPEAN LEVEL IS LACKING; INDEED, THE ABSOLUTE DIFFERENCE BETWEEN BRITISH AND FRENCH-GERMAN LEVELS OF PER CAPITA INCOME HAS GROWN.

11. THE DEVELOPMENTS THAT WERE TO UNDERLAY A HIGHER UNCLASSIFIED

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PAGE 04 LONDON 18000 02 OF 03 011958Z POSS DUPE

BRITISH GROWTH RATE HAVE NOT TAKEN PLACE. BRITAIN'S EFFICIENCY HAS PROBABLY DECLINED RELATIVE TO ITS

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PAGE 01 LONDON 18000 03 OF 03 011955Z POSS DUPE
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UNCLAS SECTION 03 OF 03 LONDON 18000

EUROPEAN PARTNERS. IMPROVEMENT IN OUTPUT PER MANHOUR IN MANUFACTURING IN BRITAIN HAS BEEN LOWER THAN IN FRANCE, GERMANY AND ITALY BOTH BEFORE AND AFTER ACCESSION, BUT WHILE THE OTHER COUNTRIES HAVE ROUGHLY MAINTAINED THEIR 1969-72 PACE IN 1972-76, BRITAIN'S PERFORMANCE HAS RADICALLY WORSENEDED. INVESTMENT, ANOTHER AREA WHERE BRITISH PERFORMANCE WAS UNFAVORABLY COMPARED TO THAT OF THE CONTINENTAL STATES, SHOWS A CONVERGENCE -- BUT BECAUSE THE SHARE OF GNP DEVOTED TO GROSS FIXED CAPITAL FORMATION IN OTHER EUROPEAN COUNTRIES HAS COME DOWN TOWARD A RELATIVELY UNCHANGED UK LEVEL.

12. ENTRY INTO THE EC HAS OBVIOUSLY NOT BEEN A MIRACLE
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PAGE 02 LONDON 18000 03 OF 03 011955Z POSS DUPE

DRUG FOR THE BRITISH ECONOMY. BUT THIS HAS BEEN A PERIOD WHEN REAL GROWTH HAS BEEN HAMPERED BY THE OIL PRICE INCREASE, BY DAMPENING OF DEMAND TO STEM INFLATION, AND OTHER FACTORS THAT HAVE NOTHING TO DO WITH THE EC. THESE SAME FACTORS HAVE CONTRIBUTED TO REDUCING ALREADY LOW PROFITABILITY LEVELS AND DISCOURAGING INVESTMENT (A PHENOMENON NOT LIMITED TO THE UK). BRITAIN'S PRODUCTIVITY PROBLEMS HAVE DEEP ROOTS, AND LABOR ATTITUDES AND MANAGEMENT SKILLS WILL TAKE MORE THAN THE EC TO CHANGE THEM.

13. TOO MUCH STRESS WAS UNDOUBTEDLY PUT ON THE ECONOMIC CONSEQUENCES OF BRITISH ACCESSION TO THE EC BY BOTH PRO- PONENTS AND OPPONENTS. THE EFFECTS OF WHAT THE EC IS AND DOES ARE MINOR COMPARED TO WHAT IT DOESN'T DO -- THE LACK

OF COMMON MONETARY AND ENERGY POLICIES MEANS THAT THE EC HAS BEEN IRRELEVANT TO THE GUT ECONOMIC PROBLEMS OF THE 1970'S.

14. BUT THE ECONOMIC ALTERNATIVE TO CONTINUED PARTICIPATION IN THE EC IS UNCLEAR. THE INTERDEPENDENCE OF THE UK AND THE CONTINENT HAS GROWN, IN A WAY THAT WOULD BE HARD TO REVERSE. THERE ARE THOSE, AS IN THE CAMBRIDGE ECONOMIC POLICY GROUP, WHO ADVOCATE THE RE-ERECTION OF THE CUSTOMS BARRIERS BETWEEN THE UK AND THE EC, OUT OF A PROFOUND LACK OF CONFIDENCE IN BRITAIN'S ABILITY TO COMPETE. BUT THE MAJORITY OF INFORMED BRITISH OPINION SEES NO GAIN IN A REVERSAL OF ECONOMIC INTEGRATION -- WHATEVER THEY MAY THINK ABOUT POLITICAL INTEGRATION. BREWSTER

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: COMMUNITY RELATIONS, MEMBERSHIP, ECONOMIC CONDITIONS
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Disposition Approved on Date:
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Disposition History: n/a
Disposition Reason:
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Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
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Litigation History:
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Office: ACTION EUR
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 7
Previous Channel Indicators: n/a
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 28-Jan-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 416434
Secure: OPEN
Status: NATIVE
Subject: BRITAIN IN THE EUROPEAN COMMUNITY - THE ECONOMIC IMPACT
TAGS: EGEN, UK, EEC
To: STATE
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/0858350f-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
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EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009